Date: March 16, 2018

To: Energy and Telecommunications Interim Committee

From: Leroy Beeby, Principle, Beeby Consulting LLC.

Re: Small Water and Sewer Utility Regulation in Montana

Committee members:

My name is Leroy Beeby, and I am a principle at Beeby Consulting, LLC. 1620 Townsend Ave Helena, MT 59601, an independent consulting firm representing small utilities. I have had the unique opportunity to help draft the "Simplified" rules for small water companies as well as now, trying to implement those rules *as intended* when drafted.

First, I'd like to extend a thank you to Sonja Nowakowski for putting together the program evaluation. She did an excellent job summarizing the history of the saga of small water and sewer utilities.

There is a discussion in the "History" section of that evaluation I would like to call to your attention. House Bill 765, which primarily exempted municipalities from PSC oversight, saved municipalities in 1981, $10 to $15 thousand dollars every time the municipality needed to change rates. In that legislation, the MCC constitutional authority is maintained. MCC can be present and participate in any municipal rate hearing.

In today's environment, those costs still exist for private water and sewer utilities. They are fully collectible in customer rates, but the company has to be able to weather that recovery over a number of years. Commissioner Gallagher directed staff (including myself) to draft rules to help alleviate that burden. I think it is important to note, the MCC was given ample opportunity to constructively participate in the rule making process and chose just to oppose the rule and instead decided to rely on its constitutional right to be present and participate. The rules were drafted and in theory should have worked. A company files for standard rates, and in three years, file for a continuation of the standard rates, file according to the operating ratio methodology, or file a general rate case.

Unfortunately, that isn't the case presently. Presently, there is an "abbreviated" process to "lessen the burden" to companies in establishing rates or requesting the continuation of standard rates. There is no operating ratio method. This "abbreviated" process still allows discovery, which requires hiring an attorney because it is a legal filing and oftentimes a consultant to protect the interests of the company. The costs of those in todays' dollars can easily exceed $20k. The PSC has taken the position that in order to recover those costs caused by the MCC and other intervenors, a company must file a standard rate case. This is consistent with a regulatory principle called "confiscatory ratemaking" and was held to be illegal. Its argument is that the company applied for "standard rates." The standard rates, when developed, did not take into consideration the cost of the regulatory burden requested by the MCC and encouraged by the PSC through its "abbreviated process."

The process does not allow cross examination of intervenor testimony so intervenors can be fairly creative without the concern of cross examination. I believe it was MCC's position in the previous meeting "Rates without regulation $50, rates with regulation $40" or something very close to that. MCC's representative also stated at a meeting with myself and the PSC, and I sincerely hope the MCC was only being over-zealous in that a company without a rate base (the rate base is what the "return" is calculated on), deserves no return, but only the expenses of operating the business. Those comments pre-prejudices the position of the MCC and were obviously made by someone who never has owned a business. The MCC has no investment in the outcome of any of the PSC's decision and has a virtually unlimited budget and availability of consultants. The process does not cost the MCC anything and ultimately, the costs caused by the MCC are born by the customers of the company. Regardless, it's the company that shoulders the blame for this unnecessary regulatory expense.

The PSC has chosen thus far not to pursue compliance with the requirement to be regulated. Prior to Commissioner Gallagher's service, primarily the only time a utility would come in to be regulated was when there was a customer complaint and the PSC forced the issue. The PSC is proposing a change to the small filing rules stating that it will "prioritize" compliance to companies that have customer complaints. As I interpret the proposed change, the PSC sets into rule that the PSC isn't interested in regulating companies unless someone complains, thereby negating any necessity for a compliance effort. That approach penalizes companies that are or want to be legal and properly regulated.

I believe absolutely that these small water and wastewater utilities should be regulated. I do not however, believe in regulation for regulation sake, and especially at the cost presently being forced onto companies.

The only practical solution I can see is to statutorily establish a rate cap on the utilities, ideally tied to an outside report, such as the DNRC survey. This is consistent with the rate cap on small telecommunications companies in Montana so is not a new approach. That rate cap would be de facto, just and reasonable. When the standard rates were developed, it was the best estimate that staff (me) could come up with at that time. If I had been aware of the DNRC survey, I would have suggested tying to that rate in the first place. If a company can support a revenue requirement in excess of that rate cap, then they would be required to support it through a contested case filing, either the operating ratio (when it exists) or a standard rate case. This would virtually eliminate any need by the PSC or MCC to rate regulate small water and waste water utilities. The MCC would still retain its right to be present and participate in any rate hearing.

The MCC will argue that each company has a different cost structure so the "return" would be different and as a result, the revenue would need to be adjusted. My question is why? The company's revenue would be capped. The company's return would be predicated on how efficient it can be run. Take two companies with 100 customer each. One company, the owner does much of the work himself/herself. The other hires a company to run the system. Under MCC's approach, the revenue for each company would be much different. The company whose owner runs the system is penalized for working as there is no cost for labor shown, where the other company is allowed cost recovery for the company that was hired. The reduction brought about by avoiding costs is simply ignored. As a result, the MCC is literally forcing inefficiency and excess costs onto the system.

Another argument will be that there will be an upward pressure on rates that are less than the price-cap. This may be true but can be minimized by requiring a phase in process as was intended in the original standard rate rules. The effect will be a stabilization of rates and not subject customers to extreme rate volatility. As DNRC's sample group gets larger, the less effect any one system has on the average. The average rate may increase over time, but expenses do as well. Remember that the only ones in this group that can change their rates without a rate application to the PSC are homeowner's association, water districts, and municipalities, all of which try to minimize their increases.

The PSC and MCC will both argue that there will be a huge influx of companies brought on by this change. I don't foresee a huge number of companies beating down the doors to become regulated. The present approach of the MCC and PSC has pretty much assured that. With a rate cap, regulatory oversite would consist of registering them, getting the tariffs filed, and if necessary establish a phase in process of rates and would not require additional staff for either the PSC or MCC. The customers would benefit from the consumer protection of the PSC and rate stability. I would venture a guess that 80% of the compliance could be accomplished in less than 1 year. The efforts would be primarily clerical in nature and could actually be subcontracted out. After the initial compliance effort, DNRC could simply notify the PSC about any systems that met its de-minimus requirements and the PSC would determine if compliance is necessary. Compliance would be much easier to obtain.

To keep "bad actors" in line, a process could be put into place wherein after a number of complaints by its customers, or bad tests by the DNRC, a rate hearing could be held to determine if that company should have its revenues reduced as a result of its actions. They would be allowed move back to the standard rates after a period of time after they corrected the problems and were back in compliance.

In summary, any form of rule or law change other than a rate cap will cause some process where a company will be forced to hire an attorney and quite possibly a consultant in order to protect its interest. It will cause companies to only become regulated if forced. A rate cap will not only protect consumers from extreme volatility in rates, but unneeded costs as well. It will provide the company with an opportunity to make a fair return and make the system worth something. It will not usurp MCC's constitutional rights nor cause a huge regulatory burden on either the MCC or PSC.